

Message Text

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PAGE 01 MONTEV 00364 031546Z

43

ACTION ARA-10

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SUBJ: ECONOMIC PLANS DELAYED

REF: MVD 3758

1. SUMMARY: GOU HAS DEVELOPED PLANS TO DEAL WITH THE ACCELERATING INFLATION HERE AS WELL AS MEET THE CONDITIONS PROPOSED BY THE IMF NEGOTIATING GG TEAM (REFTEL. THESE PROPOSALS HAVE BEEN HELD UP, APPARENTLY BY A CONTINUING INTENSE STRUGGLE WITHIN THE GOVERNMENT AND MILITARY OVER THE PROPOSED AUSTERITY MEASURES. SOME SOURCES PREDICT AN ANNOUNCEMENT NEXT WEEK, WHILE OTHERS BELIEVE MOST OF FEB WILL BE NEEDED. THE PACKAGE OF MEASURES BEING CONSIDERED INCLUDES DEVALUATION, A STRICT WAGE/PRICE FREEZE, BUDGET CUTS, CREDIT CONTROLS AND A POSSIBLE CHANGE IN THE IMPORT REGIME. END SUMMARY.

2. THE GOU ECONOMIC TEAM, HEADED BY MINISTER VEGH VILLEGAS, SEVERAL WEEKS AGO WORKED OUT A PACKAGE OF MEASURES INTENDED TO DRAMATICALLY ARREST URUGUAY'S SEVERE INFLATIONARY PROBLEMS. WITH AN INFLATION RATE OF ABOUT 105 PERCENT FOR 1974, APPARENTLY ACCELERATING BY THE YEAR END TO THE RATE OF 8-10 PERCENT PER MONTH, BOTH THE GOU AND THE IMF--WITH WHICH IT IS NEGOTIATING A STANDBY--

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PAGE 02 MONTEV 00364 031546Z

FEEL THAT AN EFFECTIVE STABILIZATION PROGRAM IS A PRIORITY TARGET.

ALTHOUGH THE PACKAGE AS DEVELOPED HAS NOT BEEN FULLY REVEALED, WE UNDERSTAND THAT IT INCLUDES A DEVALUTATION IN THE COMMERCIAL RATE OF ABOUT 20 PERCENT, WHICH WOULD MAKE POSSIBLE THE UNIFICATION OF THE FINANCIAL AND COMMERCIAL FX RATES. THERE WOULD THUS BE A FREE FLOAT AND CONVERTIBILITY AT AN EQUILIBRIUM RATE. A GOVERNMENT-ORDERED WAGE INCREASE OF PERHAPS 15 PERCENT, TOGETHER WITH PRICE INCREASES OF 5 PERCENT, WOULD BE FOLLOWED BY A STRICT WAGE/PRICE FREEZE. THERE ARE DISCUSSIONS OF SUBSTANTIALLY LIBERALIZING THE PRESENT IMPORT REGIME WHICH MAY INCLUDE THE ELIMINATION OF IMPORT QUOTAS. WE ARE LESS CLEAR ABOUT THE ALL-IMPORTANT MONETARY AND FISCAL REFORMS BEING PROPOSED, BUT WE UNDERSTAND THAT THEY INCLUDE BUDGET CUTS IN THE AREA OF SOCIAL WELFARE PAYMENTS AND SUBSIDIES. ON THE CREDIT SIDE, THE ECONOMIC TEAM IS PROPOSING MUCH TIGHTER CENTRAL BANK CONTROL, ESPECIALLY AFFECTING THE BANCO DE LA REPUBLICA'S FREEDOM TO EXPAND CREDIT.

3. EMBASSY UNDERSTANDS THAT THIS PROGRAM RAN INTO HEAVY OPPOSITION WHEN PRESENTED TO THE GOVERNMENT AND MILITARY LEADERS. GEN. RAIMUNDEZ AT THE BANK OF THE REPUBLIC IS STRONGLY OPPOSED TO CENTRAL BANK CONTROL, AND OTHER MILITARY LEADERS ARE CONCERNED ABOUT ADVERSE POLITICAL REACTION ANTICIPATED FROM A TIGHT AUSTERITY PROGRAM. WE ARE TOLD THERE HAVE BEEN OPEN CONFRONTATIONS AND, LESS CERTAINLY THAT MIN. VEGH VILLEGAS HAS ONCE AGAIN THREATENED TO RESIGN IF HIS PROGRAM IS NOT ACCEPTED.

4. THE ISSUE IS STILL TO BE RESOLVED. MEETINGS OF THE GOVERNMENT'S ECONOMIC AND SOCIAL COUNCIL ARE SCHEDULED FOR NEXT WEEK. IT IS KNOWN THAT AT LEAST SOME FACTIONS OF THE MILITARY ARE PRESSING TO AMEND THE PROGRAM HOWEVER, THE ECONOMIC TEAM MAY WELL FEEL THAT ONLY THE TOTAL PACKAGE HAS A REASONABLE CHANCE OF ACHIEVING THE TARGETS. THESE AMBITIOUS OBJECTIVES INCLUDE CUTTING IN HALF THE GOVERNMENT'S FISCAL DEFICIT, WHICH FOR 1974 AMOUNTED TO 32 PERCENT OF EXPENDITURES. ON INFLATION, THE OBJECT WOULD BE TO BREAK URUGUAY'S LONG INGRAINED EXPECTATIONS AND REDUCE INFLATION TO 15-20 PERCENT IN 1975.

5. COMMENT: THIS STRUGGLE SHAPING UP AS URUGUAY'S "MOMENT OF TRUTH" ON ECONOMIC POLICY, WILL ALSO HAVE IMPORTANT SOCIAL AND POLITICAL IMPLICATIONS. BECAUSE OF THE LIMITED OFFICIAL USE

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PAGE 03 MONTEV 00364 031546Z

FUNDAMENTAL ISSUES BEING FACED, IT IS NOT SURPRISING THAT THERE IS MUCH AGONIZING OVER THE DECISIONS TO BE MADE.
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